

Policy and
Oversight



Financial and Performance Audit
Directorate

Quality Control Review

Coleman Davis and Shure
Grant Thornton LLP
Georgia Tech Research Corporation
Fiscal Year Ended June 30, 1995

Report Number PO 97-034

June 30, 1997

Office of the Inspector General
Department of Defense

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Acronyms

AICPA	American Institute of Certified Public Accountants
DCAA	Defense Contract Audit Agency
DoD	Department of Defense
GAS	Government Auditing Standards
GAAS	Generally Accepted Auditing Standards
GTRC	Georgia Tech Research Corporation
OMB	Office of Management and Budget



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June 30, 1997

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SUBJECT: Quality Control Review of Grant Thornton LLP
Georgia Tech Research Corporation
Fiscal Year Ended June 30, 1995
Report No. PO97-034

Introduction

We are providing this report for your information and response. The firms of Coleman Davis & Shure (Coleman); Grant Thornton LLP (Grant Thornton); and the Defense Contract Audit Agency (DCAA) performed the single audit for the Georgia Tech Research Corporation (GTRC), Atlanta, Georgia, a nonprofit organization. The audit is required by Office of Management and Budget (OMB) Circular A-133, "Audits of Institutions of Higher Education and Other Nonprofit Institutions." The GTRC expended approximately \$128.6 million against Federal awards, representing \$88.2 million for the Department of Defense (DoD) and \$40.4 million for other Federal agencies for the fiscal year ended June 30, 1995.

Coleman issued its audit report November 27, 1995. The report contains an unqualified opinion on the financial statements of GTRC.

Grant Thornton issued its audit report June 18, 1996. The report contains an unqualified opinion on compliance with certain, specific requirements and positive and negative assurance statements on compliance with certain, general requirements. Positive assurance states that, with respect to the items tested, the results of the auditors' procedures disclosed no material instances of noncompliance. Negative assurance states that, with respect to the items not tested, nothing came to the auditors' attention that caused them to believe that the institution has not complied in all material respects. Also, Grant Thornton obtained an understanding of the internal controls related to the financial statements and Federal awards. The audit report describes the auditors' scope of work in obtaining that understanding and assessing control risk.

The DCAA issued its Incurred Costs Audit Report June 7, 1996. The report contains no questioned direct or indirect costs of the GTRC and did not contain an overall opinion.

Quality Control Review Results

The working papers supporting the Coleman and Grant Thornton portions of the OMB Circular A-133 audit generally met the applicable guidance and regulatory requirements in the Circular and its related Compliance Supplement which incorporate requirements contained in Government Auditing Standards (GAS) and generally accepted auditing standards (GAAS). The complete audit report submission, however, did not meet the reporting requirements of OMB Circular A-133. We found deficiencies that must be corrected for us to accept the OMB Circular A-133 audit. Those deficiencies are noted later in the Discussion of Findings.

Quality Control Review Objective

The objective of a quality control review is to ensure that the audit was conducted in accordance with applicable standards and meets the auditing requirements of OMB Circular A-133. As the Federal oversight agency for GTRC, we conducted a quality control review of the audit working papers. We focused our review on the following qualitative aspects of the audit: due professional care, planning, supervision, independence, quality control, internal controls, substantive testing, and general and specific compliance testing.

We reviewed the most recent peer reviews of Coleman and Grant Thornton dated December 6, 1994, and October 3, 1995, respectively. The Grant

Thornton review, performed by BDO Seidman LLP, found that Grant Thornton met the objectives of the quality control review standards established by the American Institute of Certified Public Accountants (AICPA) and that those standards were being complied with during the fiscal year ended May 31, 1995. The Coleman review, performed by Borland, Benefield, Crawford and Webster, P.C., found that, except for inadequate supervision regarding workpaper documentation of audit procedures for certain audits, Coleman met the objectives of the quality control review standards established by the AICPA, and that those standards were being complied with during the fiscal year ended June 30, 1994. Coleman is working to correct the deficiency.

Scope and Methodology

We used the 1991 edition of the Uniform Quality Control Guide for Single Audits (the Guide) that was approved by the President's Council on Integrity and Efficiency as guidance for performing the quality control review procedures. The Guide is organized by the general and field work audit standards and the required elements of a single audit. The Guide is further divided into the substantive work performed during the audit of the financial statements and the specific program compliance testing for major programs. In addition, we supplemented the Guide to include additional review of transaction testing. We did not review the working papers supporting the work done by the DCAA as part of the single audit of GTRC. We conducted our review from October 28 through November 1, 1996.

Coleman was engaged to perform a financial statement audit of GTRC. Grant Thornton was engaged to perform only certain, general and specific requirements related to major Federal financial award programs of GTRC. Grant Thornton tested the general requirements to include cash management, Federal financial reports, and the administrative requirements of interest on advances, program income, and revolving fund payments. Grant Thornton tested the specific requirements to include matching, level of effort, and special reporting. The DCAA performed an incurred costs audit of GTRC. That audit included tests of certain general requirements, including allowable costs and cost principles tests related to expenditures of Federal research and development awards.

Results of Prior Quality Control Reviews

We have not previously performed a quality control review of Coleman. Since January 1, 1995, we have performed one quality control review of Grant Thornton. That review noted no findings. The DCAA reports and operations are reviewed by this office on an ongoing basis.

Background

The Inspector General Act of 1978, as amended in 1988 by Public Law 95-452, prescribes the duties and responsibilities of that office. In implementing those responsibilities, the Inspector General is required to "take appropriate steps to assure that any work performed by non-Federal auditors complies with the standards established by the Comptroller General."

The Single Audit Act of 1984 (Public Law 98-502) was intended to improve the financial management of state and local governments whose total annual expenditures are \$100,000 or more with respect to Federal financial assistance programs; establish uniform requirements for audits of Federal financial assistance; promote efficient and effective use of audit resources; and ensure that Federal departments and agencies rely on and use the audit work done under the Act, to the maximum extent practicable.

The Single Audit Act Amendments of 1996, based on 12 years of experience under the 1984 Act, are intended to strengthen the usefulness of single audits by increasing the audit threshold from \$100,000 to \$300,000 in Federal financial assistance before an audit is required under the Act; selecting programs to be audited on the basis of risk assessment rather than the amount of dollars involved; and improving the contents and timeliness of single audits. The Amendments also bring nonprofit organizations, previously covered by similar requirements under the OMB Circular A-133, under the Single Audit Act provisions.

The OMB Circular A-133 establishes the Federal audit and reporting requirements for nonprofit and educational institutions whose Federal awards are or exceed \$100,000. The Circular provides that an audit made in accordance with the Circular shall be in lieu of any financial audit required under individual Federal awards. An agency must rely on the audit to the extent that it provides the information and assurances that an agency needs to implement its overall responsibilities. The coordinated audit approach provides for the independent public accountant, Federal auditor, and other non-Federal auditors to consider each other's work in determining the nature, timing, and extent of their respective audit procedures. The Circular also requires that the cognizant agency obtain or conduct quality control reviews of selected audits made by non-Federal auditors and provide the results, when appropriate, to other interested organizations. When the OMB has not assigned a cognizant agency, then the Federal agency that provides the predominant amount of direct funding to a recipient is designated as the oversight agency. The oversight agency is responsible for providing technical advice and counsel to institutions and independent auditors when requested by the recipient and may assume all or some of the responsibilities normally performed by the cognizant agency. The

Circular is being revised to incorporate the changes in the Single Audit Act Amendments of 1996.

Discussion of Findings

Procurement of the GTRC Audit. The OMB Circular A-133 Attachment, paragraph 2.a., requires nonprofit institutions that receive \$100,000 or more a year in Federal awards to have an audit conducted in accordance with the provisions of the Circular. The Circular requires that the audit be made by an independent auditor in accordance with GAS, promulgated by the Comptroller General of the United States. In a financial statement audit conducted in accordance with GAS, the auditor assumes additional responsibilities, beyond those assumed in an audit conducted in accordance with GAAS, to report on compliance with laws and regulations and on the internal control structure.

The GTRC did not procure the required audit services in accordance with GAS. Specifically, only a financial audit report in accordance with GAAS was procured. Additional requirements of an audit report in accordance with GAS include a report on internal controls and a report on compliance with laws and regulations. While arranging for the OMB Circular A-133 audit is the responsibility of the recipient, the auditor should have recognized that reliance would be placed on the audit results by the Federal Government and all other levels of government that provide substantial funds to the recipient. Specifically, paragraphs 21 through 23 of SAS No. 74 describe the auditor's responsibility when he or she has been engaged to perform an audit in accordance with GAAS and becomes aware that the entity is subject to an audit requirement that may not be encompassed in the terms of the engagement. In such a situation, SAS No. 74 requires that the auditor communicate to management and the audit committee, or to others with equivalent authority or responsibility, that an audit in accordance with GAAS alone may not satisfy the relevant legal, regulatory, or contractual requirements. The auditor should consider how the client's actions in response to such communication relate to other aspects of the audit, including the potential effect on the financial statements and on the auditor's report on those financial statements.

We found that the engagement letter between the firm of Coleman and GTRC did not require that Coleman conduct a financial audit in accordance with GAS. Therefore, Coleman did not report on compliance with laws and regulations that if violated could have a direct and material effect on the GTRC financial statements and did not report on the internal control structure. Reporting on compliance and internal controls at the financial statement level provides the Federal awarding agencies the needed assurances concerning the recipient's financial statements in order to proceed with such actions as negotiating indirect cost rates.

Schedule of Federal Awards. The OMB Circular A-133 Attachment, paragraph 15.c.(1), requires that the recipient identify, in its accounts, all Federal funds received and expended and the programs under which the funds were received. The identification of these funds includes funds received directly from Federal agencies, through other state and local governments or other recipients. In connection with the state-wide single audit, the State of Georgia Department of Audits included Georgia Tech, a unit of the University System of the State of Georgia, in its audit to meet the requirements of OMB Circular A-128, "Audits of State and Local Governments." GTRC is a separate nonprofit organization affiliated with Georgia Tech. GTRC and Grant Thornton erroneously concluded that the state-wide OMB Circular A-128 audit included the Schedule of Federal Financial Assistance for GTRC. We confirmed that the OMB Circular A-128 audit did not include the schedule of Federal financial assistance for GTRC. The following erroneous statement was made in each report included in the Grant Thornton portion of the OMB Circular A-133 audit report.

"The State of Georgia, Department of Audits included the Georgia Institute of Technology (Georgia Tech) in its audit to meet the requirements of OMB Circular A-128 with respect to the State of Georgia as a whole. That audit included the schedules of federal financial assistance for Georgia Tech and GTRC for the year ended June 30, 1995."

GTRC is required to prepare a Schedule of Federal Awards that identifies major programs. Failure to prepare the schedule and obtain an opinion on it does not ensure that major programs were properly identified and, therefore, received appropriate compliance testing.

The State auditors are not responsible for the GTRC Schedule of Federal awards, and their audit report on the Schedule of Federal Financial Assistance for the State of Georgia does not cover GTRC Federal awards. Grant Thornton and GTRC did not adequately consider that there is no relationship between the State auditors and GTRC. Grant Thornton did not determine through audit procedures that the Schedule of Federal Financial Assistance for the State of Georgia had no effect on the OMB Circular A-133 for GTRC. A Schedule of Federal awards was not prepared by GTRC and an opinion on the Schedule of Federal Awards was not rendered by Grant Thornton. Therefore, we cannot properly identify the expenditures of Federal awards for each Federal agency.

Compliance Requirements. The Attachment to OMB Circular A-133, paragraph 13(c)(1), requires that the auditor determine whether the recipient has complied with laws and regulations that may have a direct and material effect on its major Federal programs. In determining compliance with the laws and regulations, the auditor is required to select and test a sufficient number of transactions to support an opinion on compliance with specific requirements

related to each major programs. This opinion should cover type of services allowed or not allowed (including, as set forth in the general requirements, compliance with the cost principles), eligibility of program beneficiaries, matching requirements, Federal financial reports, and special tests and provisions. The compliance supplements identify general requirements for which the auditor should test compliance in all OMB Circular A-133 audits whether or not the recipient has major programs. The auditor is not expected to express an opinion on a recipient's compliance with the general requirements. The DCAA, in its incurred costs audit report, did not report on compliance with the following general requirements: political activity; Davis-Bacon Act; civil rights; and drug-free workplace requirements. GTRC and the DCAA did not adequately consider all of the requirements of the OMB Circular A-133. Therefore, the report on compliance with general requirements is incomplete and does not contain the required statements of positive and negative assurance required by the Circular.

Recommendations for Corrective Action

We recommend that the Georgia Tech Research Corporation:

1. Prepare a Schedule of Federal Awards, have the schedule audited in accordance with Office of Management and Budget Circular A-133, and submit the schedule and the report on the Schedule of Federal Awards to the Office of the Inspector General, DoD.
2. Obtain the required audit reports on internal controls and compliance with laws and regulations, which are required as part of the financial statement audits under Office of Management and Budget Circular A-133.
3. Obtain from the Defense Contract Audit Agency the required statements regarding political activity; Davis-Bacon Act; civil rights; and drug-free workplace requirements.

Discussion of Results

During our quality control review, we reviewed and took no exception to the working papers supporting the following reports and schedule.

Independent Auditors' Report. The auditor is required to obtain reasonable assurance about whether the financial statements are free of material misstatement. We reviewed the audit program and the testing of the evidential matter to determine whether testing was sufficient based on assessment of

control risk to warrant the conclusion reached and whether the working papers support the conclusion.

Report of Independent Certified Public Accountants on Compliance With Certain Specific Requirements. The auditor is required to form an opinion on whether the recipient has complied with specific requirements, including matching, level of effort, special reporting, and special tests and provisions. We reviewed the audit program for the appropriate procedures, checked the audit program steps to those in the Compliance Supplement to make sure all areas are audited, reviewed the working paper documentation and its support, reviewed the compliance tests performed, and evaluated selected compliance items.

Report of Independent Certified Public Accountants on Compliance With Certain General Requirements. The auditor is required to determine whether the recipient has complied with certain general requirements. The auditor's procedures were limited to those prescribed in the OMB Compliance Supplement for "Audits of Institutions of Higher Learning and Other Non-Profit Institutions." We reviewed the audit program for the appropriate procedures, compared the audit program steps to those in the Compliance Supplement to make sure all areas are audited, reviewed the working paper documentation and its support, reviewed the compliance tests performed, and evaluated selected compliance items.

Report of Independent Certified Public Accountants on the Internal Control Structure Over Compliance With Certain Requirements. The auditor is required to obtain an understanding of the internal control structure and assess control risk to determine whether the auditor intends to place reliance on the internal control structure. The auditor must perform tests of controls to evaluate the effectiveness of the design and operation of the policies and procedures in preventing or detecting material noncompliance. We reviewed the audit program for the appropriate procedures, the working paper documentation, and the test of controls performed.

Schedule of Findings and Questioned Costs. The auditor is required to report findings in the audit report. The recipient is responsible for forwarding the findings to the Federal grantor agencies. Immaterial findings are not required to be in the audit report but should be provided to the recipient in writing in a separate communication. All findings pertained to the DoD. We traced the findings in the report to the appropriate documentation in the audit working papers. A list of findings at GTRC is in Enclosure 1.

Comments

Since this report contains findings and recommendations regarding the engagement by GTRC and the audit work, written comments are required by all the addressees within 60 days of the date of this report. The distribution of this report is in Enclosure 2. We appreciate the courtesies extended during the review. If you have questions on this report, please contact Mr. Donald Steele, Project Manager, at (703) 604-8705.



Russell A. Rau
Assistant Inspector General
Policy and Oversight

Enclosures

cc: Grant Thornton LLP, Atlanta, Georgia
Defense Contract Audit Agency, Atlanta Branch Office
Director, Defense Procurement
Office of Naval Research, Arlington, Virginia

GEORGIA TECH RESEARCH CORPORATION

SCHEDULE OF FINDINGS

<u>FINDING</u>	<u>TITLE</u>	<u>AGENCY</u>
1	Untimely Report Filings *	DoD
2	Report Approval Sheets	DoD
3	Report Submission Monitoring	DoD
4	Untimely Federal Status and Cash Transactions Reports	DoD

* Repeat finding from fiscal year 1994.

DoD Department of Defense

Enclosure 1

**Georgia Tech Research Corporation
Fiscal Year Ended June 30, 1995**

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Enclosure 2

Evaluation Team Members

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